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March 11, 2004

REDUCING HAWAII'S INCOME TAX ON WORKING-POOR FAMILIES: THREE OPTIONS

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Summary

Hawaii=s income tax on poor working families is among the nation=s very highest. Hawaii levies its income tax on a family of four with income as low as $11,600 — an amount that is less than 65 percent of the federal poverty line. A two-parent family of four with income at the poverty line in 2002 paid $378 in Hawaii income taxes, more than in all but four of the 41 states and the District of Columbia that levy income taxes.[1]

This income tax burden has the effect of making poor working families poorer. This is particularly problematic at a time when state welfare policy strives to encourage low-income families to work themselves off welfare and out of poverty.

Other portions of Hawaii=s tax system also weigh heavily on families struggling to make ends meet. Hawaii=s sales tax burden is among the highest in the nation, and — unlike sales taxes in a majority of other states — the Hawaii sales tax applies to groceries. The sales tax also applies to clothing and other necessities.

Proposals to relieve the burden of taxes, particularly income taxes, on low-income Hawaii families have been recommended and discussed at various times in the past. Most of these proposals have focused on raising Hawaii's very low standard deduction, which is only $1,900 for a married couple. The 2001-2003 Tax Review Commission recommended increasing the standard deduction and personal exemptions to the federal amount. The federal standard deduction was $7,850 for married couples in 2002. Most recently the governor proposed increasing Hawaii=s standard deduction to $4,200 for married couples.[2]

Raising the standard deduction to $4,200, as debated this year, would be of modest benefit to poor families. For example, the change would increase modestly the income level at which a two-parent family of four begins owing tax, from $11,600 to about $13,900. For a

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[1] The federal poverty line is based on the federal poverty threshold — $18,390 — used by the Census bureau to determine the poverty rate. The poverty thresholds have never had separate figures for Hawaii. The Department of Health and Human Services (HHS) issues poverty guidelines which are used to determine eligibility for a variety of programs including Head Start and Food Stamps. HHS releases separate poverty guidelines for Hawaii which in 2002 is $21,160 for a family four. For comparability to other states, the poverty threshold, not the Hawaii-specific poverty guideline, is used throughout this report.

[2] The proposal also would have raised the standard deduction from $1,650 to $3,700 for heads of households; $1,500 to $2,500 for single filers; and $950 to $2,100 for married filing separately.

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family with income at the poverty line, the larger deduction would reduce income tax liability by $127. The annual revenue loss would total about $20 million.[3]

For approximately the same cost, about $20 million a year, a more targeted strategy such as a state Earned Income Tax Credit could accomplish far more tax reduction for low- and moderate-income Hawaii families who work and who have children. State EITCs piggy-back on the federal credit with the credit rising as income increases for very low-income families, and then gradually phasing out for families with higher incomes. If the credit is set at 20 percent of the federal EITC, the income level at which a two-parent family of four begins owing tax could almost double from $11,600 to $21,000. A family with income at the poverty line, instead of owing $378, would receive a refund of $288. This refund would help families to meet the burden of other taxes levied in Hawaii, such as Hawaii=s sales tax on food. The benefits of such a credit would be concentrated on families with incomes below $34,000. A state EITC can also be used to provide relief to very low-income adults who are not caring for children.

The targeted nature of an EITC would also help bring the state=s tax burden on poor families more in line with the taxes the state levies on higher-income families. At present, Hawaii's tax burden on low-income families is two-third's higher than the tax burden on the most affluent in the state. By targeting a tax cut on low- and moderate-income families, the state could reduce that imbalance.

A third option is an expansion of Hawaii's existing low-income refundable credit. The credit is currently structured such that families with incomes up to $20,000 receive a refundable credit of up to $35 per exemption ($140 for a family of four). This credit could be expanded in two ways: increasing the amount of the credit and increasing the eligibility level beyond $20,000. For example, for a cost of about $21 million, the eligibility could be expanded to $35,000 and the maximum credit could be increased to $85 per exemption. Under this structure, the income level at which a two-parent family of four begins owing tax would increase from $11,600 to $15,200, although it would still remain below the poverty line. A two-parent family of four at the poverty line would receive a tax cut of $200.

Improving the low-income refundable credit provides more relief to low-income families than a standard deduction increase of similar cost. Compared to a 20 percent EITC, the expanded low-income credit is less generous to working families with children. It is, however, more generous to the non-working poor.

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[3] Hawaii Department of Taxation, *Testimony on S.B. No. 1621 Relating to the Standard Deduction Amount.* February 6, 2003.

Table 1
Comparison of Proposals

Proposal	Cost	Change in Threshold at Which Two-Parent Family at Federal Poverty Line Owes Income Tax	Maximum Tax Cut for a Two-Parent Family of Four	Tax Cut for Two-Parent Family of Four at the Federal Poverty Line	Who Benefits?
Increase Standard Deduction	$20 million	Increased from $11,600 to $13,900	$190	$127	No tax cut for very low-income families. Some tax cuts for higher income families. Large portion of benefits to single filers without children.
20% EITC	$20 million	Increased from $11,600 to $21,000	$828	$666	Significant portion of benefits go to families with children. Only benefits working families.
Expanded Low-income Refundable Credit	$19 to $23 million	Increased from $11,600 to $15,200	$200	$200	Benefits families with and without earnings. Large portion of benefits to single filers without children.

Hawaii=s Taxes on Working-poor Families

Income Taxes

Almost two decades ago, the federal government recognized the inconsistency of encouraging poor families to work and then levying taxes that pushed them deeper into poverty. President Ronald Reagan spoke forcefully in the mid-1980's about the foolishness of taxing poor households deeper into poverty. In 1986, as part of an overall tax reform package, the federal government eliminated income tax liability for poor families. Since then, 24 of the 42 states with income taxes likewise have eliminated income tax liability for poor families.

Hawaii, however, continues to levy substantial income taxes on working-poor families, and the burden of this tax is among the highest in the nation.

- Hawaii=s income tax threshold — the income level at which families begin paying income tax — for two-parent families of four in 2002 was $11,600. Hawaii=s threshold is the sixth lowest among the 41 states and the District of Columbia with income taxes.

- The amount of income taxes a Hawaii family of four with income at the poverty line owed in 2002 was $378 — fifth highest in the nation.

- Hawaii also levies taxes on near-poor families, those with incomes 25 percent above the poverty line. Hawaii levies the fourth-highest income tax in the

country, totaling $679, on two-parent families of four with income at 125 percent of the poverty line.

Sales and Other Taxes

Hawaii=s income tax is not the only aspect of its tax system that weighs particularly heavily on low-income families. The combination of the low income tax threshold with gasoline taxes, property taxes, and in particular Hawaii sales taxes gives Hawaii overall one of the nation=s most burdensome state and local tax systems for the poor.

- Hawaii gets a larger share of its state and local tax collections from sales taxes and from excise taxes (such as gasoline taxes and utility taxes) than most other states. Sales and excise taxes in Hawaii account for 52 percent of all state and local revenue, compared with an average of about 35 percent nationwide. These taxes are regressive, which means they absorb a much larger proportion of the incomes of lower-income households than of higher-income households.

- Hawaii is one of just 13 states that taxes food at the same rate as other goods. The tax on food is more burdensome on low-income families than on middle- and upper-income families, because poorer families spend a much higher proportion of their incomes on food than wealthier families.

- In addition, low-income families pay sales tax on other necessities ranging from clothing to health services. Hawaii has one of the highest sales and excise tax burdens on low-income families in the country. Low-income families in Hawaii, on average, pay $823 per year in sales and excise taxes. On average in the U.S., low-income families pay $725 in sales and excise taxes.[4]

Total tax burdens on poor families in Hawaii are much higher than those on higher income taxpayers. The poorest 20 percent of married non-elderly couples, with an average income of $8,400, pay 12.6 percent of their income in Hawaii state and local taxes. Three-quarters of that tax bill is in the form of sales and excise taxes.[5] The top one percent of Hawaii taxpayers pays only 8 percent of its income in state and local taxes. After the federal deduction for state and local income and property taxes, the top 1 percent pays only 5.8 percent of its income in state and local taxes.

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[4] Citizens for Tax Justice and the Institute on Taxation & Economic Policy, *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States,* Washington, D.C., 2002. Data are for the lowest income 20 percent of non-elderly families in each state.

[5] Ibid.

Using the Income Tax to Relieve Taxes for the Poor

To understand how the income tax system could be changed to reduce taxes on the poor, it is useful to review the current system. For a working-poor family, the amount of income subject to tax is presently reduced by the following exemptions and deductions:

- A standard deduction of $1,900 for a married couple and $1,650 for heads of households;
- Personal and dependent exemptions of $1,040 for each filer and dependent; and
- A refundable credit of up to $35 per exemption ($140 for a family of four) for families with incomes up to $20,000.[6]

The exemptions and deductions are subtracted from a family=s income. The Hawaii tax rate schedule — nine brackets with rates ranging from 1.4 percent to 8.25 percent — is applied to the balance to compute tax liability for the year. The refundable credit amount is subtracted from the tax liability resulting in net taxes owed or, in some cases, a refund that is owed back to the taxpayer.

For poor families, this tax structure differs in an important way from the tax structures of other states. The exemptions and deductions available to low-income families are lower than those available to similar families in most other states.

In addition, unlike states with EITCs which are adjusted annually for inflation, Hawaii's refundable credit has not kept up with the cost of living in Hawaii. Hawaii's low-income refundable credit is based on Hawaii's previous grocery tax credit, which was designed to offset the sales tax on food. However, the credit no longer offsets even the most "thrifty" family's food cost. According to the United States Department of Agriculture (USDA), a "thrifty food plan" for a Hawaii family of four is $690 per month, or $8,280 per year. A family that spent that amount on food could pay general excise tax of $331 per year — $191 more than the maximum low-income refundable credit of $140.[7]

Different states have chosen different paths to relieving taxes on the poor, and these paths provide models that Hawaii could follow. In evaluating the appropriateness of any approach to

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[6] Hawaii offers other deductions as well, but most of these are unavailable to many low-income families. For example, many poor families do not own their own homes and therefore cannot claim the deduction for mortgage interest payments.

[7] It should be noted that food purchased with food stamps is not taxable. However, many low-income working families don't get food stamps. While the overall food stamp participation rate of eligible households in Hawaii is estimated to be over 90 percent, nationally the food stamp participation rate among working households with children is only 48 percent, and this population is likely to have a lower participation rate in Hawaii as well. In addition, the official participation rate data for Hawaii is questionable because of the small sample size. Finally, in many cases food stamps do not cover the full food budget.

reducing the income tax burden on the poor in Hawaii, the following five questions may be helpful to consider.

- C *Benefits.* How much would typical working-poor families actually benefit from each change? That is, what would be the actual impact on families=tax bills?
- C *Cost*. How much would it cost in lost revenue to the state?
- C *Targeting*. Would most of the total benefits go to low-income families, or would a substantial portion go to middle- and upper-income families who already have a lower overall tax burden? Is the tax credit targeted to working families with children? (The negative impacts of poverty on children provide a compelling rationale for targeting the credit to such families).[8]
- C *Work incentive.* To what extent would low-income working families receive additional benefits for each additional dollar of earnings? Would the change relieve the taxes on poor families as they enter the workforce? Would it help, rather than hinder, efforts to support a family on low-wage earnings?
- C *Impact on overall tax fairness.* Would the change help to offset the effect of other, more regressive taxes, such as the sales tax on food? Would it help families that pay substantial amounts of sales taxes, but have no income tax liability?

The remainder of this paper reviews three specific proposals for reducing the income tax on low-income families in light of these five questions.

Reducing Taxes on Working-poor Families Through an Increased Standard Deduction

During the past legislative session, several proposals to increase the standard deduction were considered by the legislature, but not enacted. The administration-sponsored bill proposed that Hawaii's standard deduction be increased in the following manner over a three year period:

- For married filing joint returns, from $1,900 to $4,200;
- For head of household returns, from $1,650 to $3,700;
- For single filers, from $1,500 to $2,500; and
- For married filing separately returns, from $950 to $2,100.

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[8] Recent research on the effect of poverty on children has shown that when all other factors are controlled for, poverty can have a substantial effect on child and adolescent well-being. Children who grow up in families with incomes below the poverty line have poorer health, higher rates of learning disabilities and developmental delays, and poorer school achievement. They are far more likely to be unemployed as adults than children who were not poor.

Such an increase would provide an income tax cut to many Hawaii taxpayers, including both poor and non-poor families. Almost 240,000 tax filers claimed the standard deduction in 2000, which is 46 percent of all resident tax returns. The change would have the following impacts.

- *Benefits*. The maximum value of an increase in the standard deduction for married couples from $1,900 to $4,200 is $190. This value reflects the increase in the deduction — $2,300 — multiplied by the state's top income tax rate of 8.25 percent. Taxpayers who fall into lower tax brackets would receive smaller benefits.

- *Cost*. The Department of Taxation estimates that increasing the standard deduction as listed above would cost about $20 million per year when fully in effect.

- *Targeting*. An increase in the standard deduction would be somewhat targeted to low-income families. High-income families tend to use the standard deduction less than poorer families; only eight percent of families with returns over $30,000 use the standard deduction, while 72 percent of families below $30,000 use the standard deduction. On the other hand, among those families that do use the standard deduction, the benefits from the increase would be greater for higher income families because of their higher tax rate.

  As shown in Table 2, lower-income families who pay Hawaii income tax at rates below the maximum rate would get less than the maximum benefit from increased deduction. The lowest income families would receive no benefit because their income level is already lower than combination of the current standard deduction and personal and dependent exemption amounts. In addition, Hawaii would remain one of the states that levy substantial income tax ($251 in this case) on families with income below the federal poverty line.

  A standard deduction increase is not targeted to families with children. A review of the available data indicates that it is likely that a significant portion of the standard deduction increase will go to single filers without children.

C *Work incentive.* With an increase in the standard deduction, a two-parent family of four would not owe any income tax until its income reached about $13,900, a boost of about $2,300 from the present level of $11,600. This would help families entering the workforce, but taxes would begin increasing for these families well before their incomes reached the poverty line.

C *Impact on overall tax fairness.* The increase in the standard deduction would not be refundable so it would not make the Hawaii tax system substantially less regressive. It would reduce families=income tax levels, but it would not offset other taxes, such as sales and excise taxes, that are the most burdensome for working-poor families. An increase in the standard deduction would, however,

Table 2
Tax Under Current Law and Under Increase in Standard Deduction
Married Couple With Two Children (Only Available to Non-Itemizers)

Family Income	Tax (Refund) Under Current Law (Standard Deduction is $1,900)	Tax (Refund) With Standard Deduction Increased to $4,200	Amount of Tax Cut
25 percent of Poverty Line ($4,598)	($144)	($144)	$0
50 Percent of Poverty Line ($9,195)	($100)	($132)	$32
Full-time, minimum-wage earnings ($11,960)	$14	($53)	$67
100 Percent of Poverty Line ($18,390)	$378	$251	$127
125 Percent of Poverty Line ($22,988)	$679	$544	$135
$50,000	$2,550	$2,376	$174
$90,000	$5,676	$5,486	$190

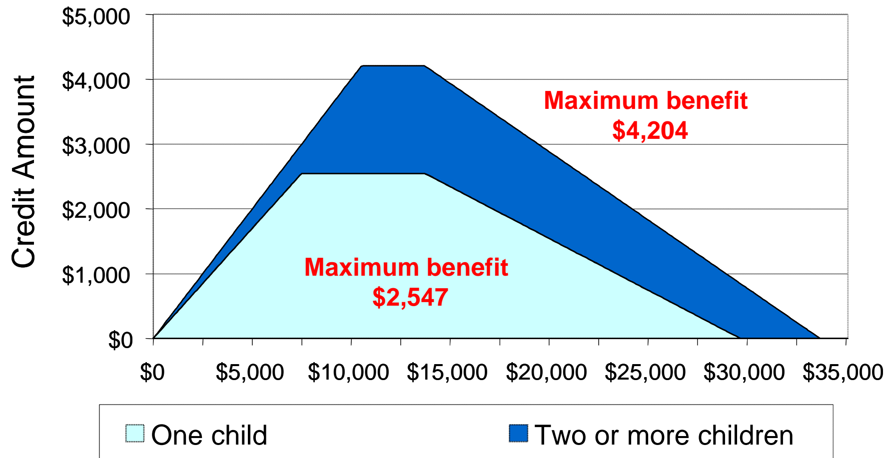
Note: Poverty line is the federal poverty threshold for 2002.

indirectly increase the amount of refunds some families receive by lowering the amount of tax they owe prior to applying the credit and, in turn, increasing the amount of the low-income refundable credit the family receives as a refund.

Reducing Taxes on Working-poor Families Through an Earned Income Tax Credit

An alternative method of reducing taxes on low- and moderate-income working families would be to offer an Earned Income Tax Credit. State EITCs provide credits to low- and moderate-income working families with children. Most also provide small credits to very low-income individuals and couples who are not caring for children in the home.

Since 1997, 10 states have enacted new Earned Income Tax Credits bringing the total number of states with EITCs to 17. EITCs have been enacted in states led by Republicans, in states led by Democrats, and in states with bipartisan leadership. State EITCs are based on the federal EITC, which is available to working families with two or more children whose incomes are below about $34,000, and to working families with one child whose incomes are below about $30,000. A federal credit is also available to individuals and couples with incomes below about $12,000 who are not caring for a child. The amount of a state EITC is typically set as a percentage of the federal credit — anywhere from 5 percent to 50 percent. In most states, EITCs



are refundable; that is, if the amount of the credit exceeds a family=s income tax liability, the balance may be refunded in the form of a payment.[9]

It would be straightforward for Hawaii to enact an EITC of its own.

- *Benefits*. The tax benefit of an Hawaii EITC would vary by income level, as the federal credit does. Families with no earnings would receive no credit. For families with low earnings, the value of the federal EITC increases as earnings rise, plateaus at a maximum credit, and then gradually declines (see graph and Table 3).

- *Cost*. A Hawaii state EITC set at 20 percent of the federal credit would cost about $20 million.[10]

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[9] The states that offer EITCs are Colorado, District of Columbia, Indiana, Illinois, Iowa, Kansas, Maine, Maryland, Massachusetts, Minnesota, New Jersey, New York, Oklahoma, Oregon, Rhode Island, Wisconsin, and Vermont. For more information about state EITCs, see *A Hand Up: How State Earned Income Tax Credits Help Working Families Escape Poverty in 2003,* Center on Budget and Policy Priorities.

[10] In 2001, Hawaii residents claimed $103 million in federal EITC benefits. Projections from the U.S. Treasury suggest that Hawaii claims will rise to $113 million annually by fiscal year 2004, which would imply that a credit set at 10 percent of the federal credit would cost $11 million. However, because this calculation assumes full participation in the state credit among residents who receive the federal EITC, it provides an upper-bound estimate of the cost of a state EITC at a given percentage of the federal credit. In practice, state EITC costs typically have been lower than the estimates derived from the above calculation, and this seems to be true for several reasons, especially in the first few years after enactment of the state credit when awareness of the credit may be limited. A more reasonable estimate would be that the cost of a Hawaii EITC would equal about 90 percent of what it would cost if every person that claimed a federal credit also claimed a state credit. This figure would accurately reflect the

- *Targeting*. An EITC is a tax credit for low- and moderate-income working families and thus would be well-targeted to address the problem of high taxes on the working poor. Working families with children who have incomes below about $34,000 would be eligible, with the largest share of EITC benefits going to working families with children with income below the federal poverty line. Despite this targeting, the credit would still be available to a substantial portion of taxpayers. About 71,275 Hawaii taxpayers, or about 1 out of every 8 tax filers, claimed the federal EITC in 2001; those taxpayers would be eligible for a state EITC as well.

  The EITC is well targeted to working families with children because some 98 percent of the benefits of the federal EITC go to families with children. To the extent that Hawaii might want to provide significant benefits to low-income working families without children in the home, it could provide a higher percentage of the federal credit to this group. For example, a state EITC can be set so that workers with children receive 20 percent of the federal credit and workers without children receive 100 percent of the much smaller federal credit for childless workers.

- *Work incentive.* For families entering the workforce, a state EITC would act as a wage supplement, increasing in value as earnings rose. It would help families meet the additional costs of working, including transportation, child care and clothing. Moreover, it would dramatically increase the income level at which a working family in Hawaii must first pay taxes. A EITC set at 20 percent of the federal credit would offset income tax entirely for a family of four with income up to about $21,000, almost double the present threshold of $11,600. This change would benefit a wide range of families that are working but whose earnings are low. For instance, Hawaii would no longer levy income tax on a family of three or four with full-time, minimum-wage earnings.

  A number of researchers have found that the large expansions of the EITC since the mid-1980s have been a major factor behind the trend toward greater workforce participation. Studies by Jeffrey Liebman and University of California economist Nada Eissa find a sizable EITC effect in inducing more single women with children to work. In addition, a study by Northwestern University economists Bruce Meyer and Dan Rosenbaum finds that a large share of the increase in employment of single mothers in recent years can be attributed to expansions of the EITC. They find that the EITC expansions explain more than half of the increase in employment among single mothers over the 1984-1996 period. Of

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experiences of other states that have enacted EITCs, including Kansas, Maryland, Minnesota and Wisconsin, each of which have found that the cost of a state EITC in the first year after enactment was 85 to 90 percent of the cost of the federal credit received by residents multiplied by the state percentage.

Table 3
Hawaii Earned Income Tax Credit
Married Couple with Two Children

Family Income	Tax (Refund) Under Current Law	Tax (Refund) after Hawaii EITC set at 20 Percent of the Federal Credit	Amount of Tax Cut
25 Percent of Poverty Line ($4,598)	($144)	($510)	$366
50 Percent of Poverty Line ($9,195)	($100)	($834)	$734
Full-time, minimum-wage earnings ($11,960)	$14	($814)	$828
100 Percent of Poverty Line ($18,390)	$378	($288)	$666
125 Percent of Poverty Line ($22,988)	$679	$207	$472
$50,000	$2,550	$2,550	$0
$90,000	$5,676	$5,676	$0

Note: Poverty line is the federal poverty threshold for 2002.

note, Meyer and Rosenbaum found evidence that *state* EITCs also contributed to workforce participation increases in the states where credits were available.[11]

- Economists have noted that the phase-out of the EITC could create some work disincentives, since the credit declines with each additional dollar earned in the phase-out range. However, research has indicated that the phase-out of the EITC has little or no impact on hours of work.[12]

C *Impact on overall tax fairness.* Because it would be well-targeted to those families bearing the highest tax burden, a Hawaii EITC would make the state=s overall tax system substantially fairer. Moreover, if the EITC were made refundable, a family with income at the poverty line could, instead of owing $378, receive a refund of $288. This refund would help families to meet the burden of other taxes levied in Hawaii, such as Hawaii=s sales tax on food and other necessities.

[11] Nada Eissa and Jeffrey B. Liebman, "Labor Supply Response to the Earned Income Tax Credit," *Quarterly Journal of Economics*, May 1996, 112(2), pp. 605-637; Bruce D. Meyer and Dan T. Rosenbaum, "Welfare, The Earned Income Tax Credit, and the Labor Supply of Single Mothers," September 1999, and "Making Single Mothers Work," National Tax Journal 53 (4, part 2) December 2000.

[12] Jeffrey B. Liebman, "The Impact of the Earned Income Tax Credit on Incentives and Income Distribution," *Tax Policy and the Econo*my, 1998.

For families with slightly higher incomes, the EITC would not provide refunds, but the impact on state income tax liability would be substantial. For example, a family of four with income at 125 percent of poverty line in 2002 paid $679 in income tax. A Hawaii EITC set at 20 percent of the federal credit for that family would equal $472, leaving a net income tax liability of $207 — a tax cut of nearly 70 percent.

Reducing Taxes on Working-poor Families By Expanding Hawaii's Low-Income Refundable Credit

A third method of reducing taxes on low- and moderate-income working families would be to expand Hawaii's existing low-income refundable credit. The current credit is based on the following benefit schedule:

Table 4
Low-Income Refundable Credit Benefit Schedule

Adjusted Gross Income	**Tax Credit per Qualified Exemption**
Under $10,000	$35
$10,000 to $14,999	$25
$15,000 to $20,000	$10
Over $20,000	$0

This credit could be expanded by increasing the amount of the credit and increasing the eligibility level beyond $20,000. For example, the eligibility could be expanded to $35,000 and the maximum credit could be increased to $85 per exemption. Below is one of several ways that the low-income refundable tax credit could be expanded.

Table 5
Possible Expanded Low-Income Refundable Credit

Adjusted Gross Income	Tax Credit per Qualified Exemption
Under $10,000	$85
$10,000 to $14,999	$75
$15,000 to $19,999	$60
$20,000 to $24,999	$40
$25,000 to $29,999	$25
$30,000 to $35,000	$10
Over $35,000	$0

- *Benefits.* The variation of the benefits by income will depend on the structure of the expanded credit. Based on the example in Table 5, taxpayers below $20,000 all receive a tax cut of $200 (see Table 6). The tax cut for families at the poverty line is larger compared to the proposed increase in the standard deduction, but

much less than would be provided by the 20 percent EITC. In fact, families at the poverty line would continue to owe a significant amount of income tax — $178. Moreover, this proposed benefit structure would only increase the income level at which a two-parent family of four begins owing tax from $11,600 to $15,200.

- *Cost.* The cost of the existing low-income credit in 2000 was $8.3 million. The benefit schedule presented above increases the credit amount and provides the credit to families who were not previously receiving it. This expansion would raise the cost of the low-income refundable credit by $19 to $23 million in the 2004 fiscal year.[13]

- *Targeting.* The expanded low-income credit is somewhat better targeted than the standard deduction increase in terms of helping poor families, but not much better in terms of targeting children. Depending on how the new credit is structured, the largest benefits potentially go to families with the lowest incomes, but many beneficiaries would be single filers without children.

Table 6
Hawaii Expanded Low-Income Refundable Credit Married Couple With Two Children

Family Income	Tax (Refund) Under Current Law	Tax (Refund) after Expanded Low-Income Refundable Credit	Amount of Tax Cut
25 Percent of Poverty Line ($4,598)	($144)	($344)	$200
50 Percent of Poverty Line ($9,195)	($100)	($300)	$200
Full-time, minimum-wage earnings ($11,960)	$14	($186)	$200
100 Percent of Poverty Line ($18,390)	$378	$178	$200
125 Percent of Poverty Line ($22,988)	$679	$519	$160
$50,000	$2,550	$2,550	$0
$90,000	$5,676	$5,676	$0

Note: Poverty line is the federal poverty threshold for 2002.

[13] This cost estimate was developed, first, by applying the higher credit amounts to taxpayers receiving the current credit — those with incomes between $0 and $20,000 — using data on the income distribution of existing credit. Second, the cost of the credit going to those making between $20,000 and $35,000 was estimated using data on the distribution of exemptions to those groups. The estimate assumes a pick-up rate of 85 percent, which is conservative because the pick-up rate for eligible taxpayers at the lower income levels appears to be about 70 percent. The estimate was adjusted for inflation between 2000 and 2004. The range provided is plus or minus ten percent of the actual estimate, $20.8 million. CBPP calculations of State of Hawaii, Department of Taxation, *Report on Credits Claimed by Hawaii Residents*, 2000.

- *Work Incentive.* An expansion of the low-income refundable credit would not provide a significant work incentive because the amount of the credit is the same for incomes up to $10,000 and then begins to decline with additional earnings. Moreover, it would be available to working and non-working families alike.

- *Impact on Overall Tax Fairness.* Similar to the EITC, because the credit is targeted to low-income families and refundable, it would make the overall tax system more fair.

Conclusion

In Hawaii the tax burden on low-income families is unusually high. Hawaii's income taxes on poor families are among the nation=s highest, and its sales and excise taxes — in particular, its sales tax on food — also are unusually burdensome on poor families.

Increasing the standard deduction would reduce the level of income taxes on poor families and would modestly increase the income level at which working families begin paying income taxes — from $11,600 to about $13,900 for a two-parent family of four The change would be worth up to $190 for a family filing jointly — a substantial benefit**.** But Hawaii's income tax on poor families would remain among the nation=s highest, and the increase in the standard deduction would do nothing to offset the regressiveness of state and local sales, excise and property taxes. Working families that are very poor would not benefit at all. A significant portion of the benefits from this tax change would go to middle- and upper-income taxpayers. Finally, increasing the standard deduction is not targeted to families with children.

By contrast, enacting a Hawaii Earned Income Tax Credit would provide greater benefits to low-income families, at a similar cost to the state treasury. It would accomplish this by targeting the tax cut to working families with children with incomes below $34,000. A Hawaii 20 percent EITC would nearly double the level at which a two-parent family of four begins owing income tax, from $11,600 to $21,000. The tax reduction for a family at the poverty line would be over $500 greater with a 20 percent EITC than with the increase in the standard deduction. In addition, a refundable EITC would help to offset the burden of the sales and excise taxes and other taxes for the lowest-income families.

A third option would be to expand Hawaii's current low-income refundable credit. This option has similar advantages to the EITC in that it is targeted and would provide greater benefits to low-income families at a similar cost to the standard deduction increase. However, the EITC has several advantages compared to the low-income refundable credit: the EITC is better targeted to families with children, the EITC is better targeted to working families, and the EITC does a better job of providing a work incentive to low-income workers.